NATIONAL INTELLIGENCE COUNCIL
ASSESSMENT

23 September 2022 NICA 2022-20360

[redacted] Likely Global Impact of a Protracted Russia–Ukraine War

(U) Key Takeaway

[redacted] ***Scope Note:*** *This assessment considers ways in which a protracted war between Russia and Ukraine—one that continues into 2023—might affect the global economy, as well as stability and governance. The assessment also considers the possible impact of the war on China's economic equities.*

[redacted] Russia's aggression against Ukraine has aggravated COVID-19-related fragilities in the global economy, raised commodity prices, fueled market volatility, and contributed to food insecurity and financial instability, particularly in developing countries. We assess that these trends will continue into 2023, as governments struggle to insulate their populations from eroding living standards linked to inflation and low economic growth.

- [redacted] Elevated food and fuel prices because of the war are aggravating preexisting governance shortcomings and financing challenges in many countries, heightening the risk of economic instability. There is a growing likelihood that at least some hard-pressed governments will divert resources away from transnational priorities such as fighting climate change to focus on domestic concerns.

- [redacted] Wildcards, including the possibility of an unusually harsh winter in Europe, could change some of these trends.

[redacted] War Leading to Higher Global Prices and Lower Growth

[redacted] Russia's military assault on Ukraine in February and continued occupation of Ukrainian territory have disrupted global energy and agriculture markets, fueled market uncertainty and volatility, and increased the risks of financial instability. No country has been immune to these effects. We assess that these factors will continue to aggravate existing fragilities in the global economy for at least the next six months, by sapping economic growth and fueling inflation.

- (U) The conflict in Ukraine and attendant economic disruptions have lowered global GDP growth projections for this year and 2023. In July, the IMF reduced its global growth forecast for this year to 3.2 percent, its second downward revision since January, saying that the war has set back the global recovery from the COVID-19 pandemic and raised the risk of geopolitical fragmentation. A consensus survey of private-sector economic forecasters in July estimated global GDP growth of 3 percent this year, a downward revision from the estimate of 4.4 percent in January.

(U) This assessment was prepared under the auspices of the National Intelligence Officer (NIO) for Economic Issues. It was drafted by the National Intelligence Council [redacted]

- (U) European economies, which together account for one-fifth of global GDP, face multiple headwinds from spillover effects from the conflict. Europe's energy supplies are likely to remain tenuous and its energy prices high and volatile, because of its longstanding reliance on oil and gas supplies from Russia and the prospect that these will now be unavailable to an unprecedented degree.

- (U) Europe faces historically high inflation rates, largely because of the shock to energy supplies. The average price per barrel of benchmark Brent oil increased by almost 40 percent during the six months following Russia's invasion, compared with the six months before, although they have decreased by 25 percent since the highs in June. In August, annual inflation in the euro area reached 9.1 percent, lowering the purchasing power of European households. The UK's inflation rate of 9.5 percent in August was its highest in 40 years.

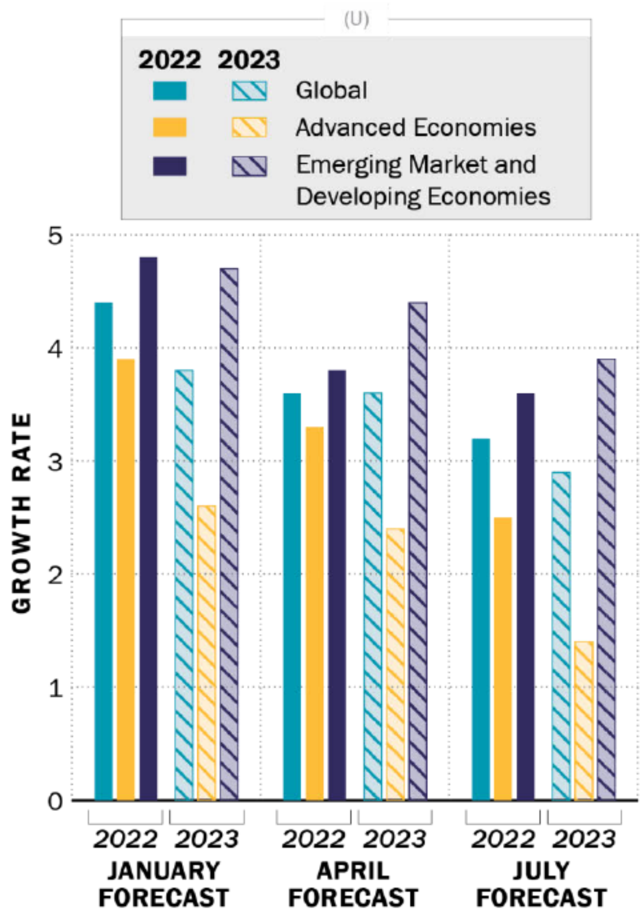
- (U) According to the IMF, high inflation reaches every region and every country. The consensus among many economic forecasters as of July expects the global inflation rate for this year to be nearly 8 percent, the highest rate in decades. In July, the IMF predicted inflation in advanced economies of 6.6 percent this year, and 9.5 percent in emerging markets.

[redacted] We assess that sanctions, disruptive Russian actions to its energy exports, and uncertainty surrounding implementation of an oil price cap will prevent a sustained softening of the price of energy for the next six months. However, this assessment reflects substantial uncertainty because slowing economic growth in China and Europe could moderate the demand for energy and consequently moderate prices.

- [redacted] Widespread natural gas and oil supply disruptions could increase inflation and severely reduce economic output in Europe, judging from European Commission and European Central Bank (ECB) forecasts. In June, the ECB forecasted that a complete natural gas cutoff from Russia would reduce Eurozone GDP growth by 1.5 and 3.8 percentage points this year and in 2023, respectively, and increase inflation by 1.2 and 2.9 percentage points during the same period. Although we assess that a complete natural gas cutoff is unlikely, a significant disruption to gas

(U) War Contributing to Lower Global Economic Growth

(U) Russia's invasion of Ukraine in February has upended global economic recovery, introducing negative spillovers across a range of drivers of growth. Higher inflation, commodity supply shocks, and reduced purchasing power have worsened growth prospects, and pushed the IMF to make multiple downward revisions to its growth forecasts as spillovers from the conflict have materialized during the year.



(U) *Source: IMF World Economic Outlook*

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flows to Europe would lower growth within the EU and almost certainly dampen global growth.

- (U) The EU has said that it will ban seaborne imports of oil from Russia as of December 2022 and of refined products from Russia as of February 2023, steps that almost certainly will put more pressure on prices. Although Russia is finding some new markets for its oil, to attract buyers Russia needs to reroute European oil flows to Asia through western-facing export terminals, which would increase shipping costs for Asian buyers, judging from industry reporting.

- [redacted] The implementation and enforcement of a price cap on Russia's oil exports would create additional volatility, particularly if Moscow followed through on threats to reduce exports. Even a partial cutoff in Russia's oil exports would put strong upward pressure on global prices and potentially create shortfalls, given Russia's importance to the market. In 2021, Russia was the world's second largest exporter of crude oil after Saudi Arabia. Russia exported about 5.1 million barrels per day (b/d) of crude and 2.3 million b/d of refined products as of June, according to the International Energy Agency.

[redacted]

(U) Oil Industry Dynamics Point to Likely Upward Pressure on Prices

[redacted] The low level of spare global oil producing capacity and the constraints on refining will be likely to raise the risk of higher oil and refined product prices during the next six months.

- [redacted] Saudi Arabia, the UAE, and other OPEC oil producers have very little spare oil production capacity to make up for potential disruptions in Russia's oil output this year, according to the International Energy Agency. This could prompt concerns about supply tightness and reduce the market's faith in available spare capacity to offset unexpected supply disruptions elsewhere in the world. Moreover, OPEC+ producers have signaled they will try to prevent a decline in oil prices during the next several months by cutting output, according to press reporting.

- [redacted] Inadequate global refining capacity probably will keep the global refined product market tight for the rest of this year, suggesting that any further supply disruptions would cause sharp price shocks. Since 2021, the global refining system has not kept pace with rising fuel demand, leading to depleted refined product inventories and record high prices for diesel, jet fuel, and gasoline, according to industry reporting.

[redacted] Food Price Volatility To Persist

[redacted] The combination of elevated energy and food prices since March has increased the number of individuals in extreme poverty and facing food insecurity, particularly in developing countries, and we assess that these countries will struggle to reverse these trends during the next six months even if global food prices stabilize. High food prices predate Russia's invasion of Ukraine and the resulting reductions in grain exports have reduced the purchasing power of millions of households and limited their ability to absorb new price hikes. The food price index published by the UN's Food and Agriculture Organization rose more than 25 percent in 2021, compared with the previous year.

- (U) UN projections for this year indicate that as many as 181 million people in 41 countries could face a food crisis or exacerbated levels of acute food insecurity. An additional 19 million more people are expected to face chronic undernourishment in 2023, if food exports from Russia and Ukraine are curtailed and global food prices remain elevated.

- (U) The currencies of a large number of emerging market and developing countries—most of which are net food importers—have depreciated since March, compounding the effects of higher food prices. An index of emerging market currencies shows a weakening of 9 percent from February to September. Global economic uncertainty has prompted shifts in capital away from weaker economies toward the relatively safer US assets, suggesting that these effects will linger even if global food prices stabilize.

- [redacted] As of September, prices for major agricultural commodities, such as corn and wheat, had subsided, and mostly returned to or approached pre-invasion levels. After the initial shock of spiking global food prices—wheat prices rose by 75 percent immediately following the invasion and remained 50 percent higher for months—prices began to fall in May, and continued their declines following the agreement in late July of a UN-brokered agreement that facilitated a resumption of food exports from Ukraine's Black Sea ports.

[redacted] Doubts about Russia's commitment to the UN-brokered deal have the potential to lead to new price spikes, and withdrawal by Russia from the agreement almost certainly would result in an increase in global food prices. For example, in early September, Russian President Vladimir Putin threatened to pull out of the UN-brokered agreement to allow Ukraine grain exports from Black Sea ports after which corn and wheat futures prices rose sharply, an indication of the sensitivity of global food prices to threats to food shipments from Ukraine's Black Sea ports.

- (U[redacted]) As of early September, the total tonnage of grain and other foodstuffs exported from three Ukrainian ports exceeded two million metric tons (MMT), but before the war, the three ports shipped on average of four MMT of grain per month.

- (U[redacted]) As of the beginning of this year, more than 25 countries were each dependent on Russia and Ukraine for more than 50 percent of their wheat imports, according to the FAO. Somalia, which is facing famine, sourced 90 percent of its wheat from those countries. In 2020, Lebanon sourced 81 percent of its wheat from Ukraine and 15 percent from Russia.

- (U) Poor households globally spend more than 40 percent of their incomes on food, compared with about 10 percent in high-income countries, making these populations particularly vulnerable to persistently high food prices, according to an FAO study.

- (U[redacted]) Weather remains a major uncertainty, and could either ameliorate or magnify the first-order food shocks emanating from Ukraine. Heatwaves and droughts are lowering food production in China, Europe, and the United States, and potentially could reverse price declines of recent months. Despite production rebounds in some large grain-producing countries such as Canada, supply declines in other grain producers could outweigh growth this year. The USDA forecasts that global corn and wheat production will fall slightly this year and in 2023, compared with 2021 levels.

(U) High Energy Prices, Fertilizer Shortages, Likely To Lower Agricultural Output

[redacted] Agriculture is an energy-intensive industry, particularly in developed regions, and stubbornly high energy prices and sanctions will continue to shape global agricultural planting and production during the next six months. Shortages of fertilizer materials, particularly potash, of which Russia is the world's second-largest exporter and Belarus is the third, also are contributing to higher prices. With elevated input prices and decreased availability of fertilizers, agricultural input prices probably will remain high, which translate into higher food prices and potentially lower yields.

- (U) Agriculture uses large amounts of energy directly through the use of fuel, gas, and electricity, and indirectly through chemicals such as fertilizers, pesticides, and lubricants. Natural gas is the main source of fuel for nitrogen fertilizer production, making energy and related fertilizer prices closely linked. Nitrogen fertilizers make up more than half of global fertilizer use, with phosphate and potash fertilizers making up the remainder.

- (U[redacted]) Although phosphate and potash fertilizers are not perfect substitutes for nitrogen fertilizers and the ratio of fertilizer use varies by crop, sharply higher prices for nitrogen fertilizers have contributed to higher demand for phosphate and potash fertilizers, which have raised their prices.

- (U[redacted]) Many developing countries tend to have poor soil quality, creating a greater need for fertilizers. [redacted]

[redacted] War Raising Risks of Economic and Societal Instability

[redacted] We assess that the economic disruptions caused by the Russian invasion of Ukraine, which include higher inflation, lower growth, and broad disruptions to commodity markets, will continue to aggravate pre-existing fragilities and weaken many countries' capacity to cope. Many developing countries began this year with depleted foreign reserves and little fiscal space to weather the fallout from Russia's invasion of Ukraine. The World Bank has estimated that the build-up of debt because of the pandemic has been the largest, fastest, and most broad-based rise in global debt during the past 50 years.

- (U) Global household savings rates probably will continue to decline this year as inflation consumes a greater share of incomes, which will undermine financial resilience and spending power. Higher expenditures are reducing the financial cushion built up by populations in many advanced economies during the pandemic. Populations in developing countries are at even higher risk because of more limited savings and government support.

[redacted] As central banks raise interest rates to manage inflation, we assess that higher debt servicing costs will limit the capacity of many countries to support government spending for their populations and maintain affordable food supplies. The least developed countries on average dedicate 14 percent of their domestic revenue to interest payments on debt, and the cost of their external borrowing averages three times that of advanced economies, according to a think tank report based on academic research.

- (U) According to data compiled by a US financial firm, the number of developing economies with sovereign debt trading at distressed levels—yields that indicate higher potential for default—more than doubled during the first six months of the year.

- (U[redacted]) [redacted]

[redacted] Net capital outflows from many developing countries will continue to weigh particularly heavily on those countries as import costs rise amid declining growth for their exports.

- (U) Many food import dependent countries will be at heightened risk of financial crisis because widening deficits are likely to deplete foreign exchange reserves and further weaken domestic currencies. In April, Sri Lanka defaulted on its foreign-currency denominated debt because of its dwindling foreign exchange reserves amid rising import costs for food and fuel. [redacted]

- (U) Almost all developing countries will see higher import prices at least through the end of this year. The IMF estimates that the historic long-term pass-through of food price shocks to domestic inflation is about four times larger for emerging and developing economies than for advanced economies.

- (U[redacted]) Unlike many developing countries that face growing pressures on their economies and social stability during the next six months, large emerging markets and commodity exporters, such as Brazil, Malaysia, Mexico, and South Africa, have shown resiliency despite the global disruptions. According to private-sector research, emerging markets with diversified economies have not experienced a diminution of their credit quality.

[redacted] Risks of Reduced Government Capacity and Rising Political Instability

[redacted] Elevated food and fuel prices resulting from the war and the COVID-19 pandemic are exacerbating preexisting governance challenges in many countries, heightening the risk of political instability globally through March 2023 and beyond. Academic studies have found that higher food prices tend to correlate with protests and riots, suggesting that high fuel and food prices may lead some governments to try to maintain unsustainable fiscal policies, such as food and fuel subsidies, to suppress the risk of destabilizing protests.

- [redacted] As of September, several countries already have experienced social unrest resulting in part from the war's economic fallout. Governments in the Western Hemisphere have remained mostly insulated from the war, but rising inflation has begun to fuel protests—some violent—in Argentina, Bolivia, Cuba, Ecuador, Haiti, Panama, and Peru.

- [redacted]

- (U[redacted]) Fuel subsidies in developing countries, particularly in Africa and in some countries in the Middle East, may become unsustainable as global energy prices remain elevated and budgets are stretched. For example, gasoline subsidies in Nigeria already consume 20-25 percent of all government revenues, according to diplomatic reporting and at least one academic study.

- (U) Analysis by a US investment bank estimates that a full cutoff of natural gas imports from Russia could drive European household energy costs up by about 65 percent, to about $512 per month.

[redacted] Undercutting Global Cooperation

[redacted] We assess that the war in Ukraine has accelerated some global trends initiated during the COVID-19 pandemic that undercut governments' focus on shared challenges such as food security and climate change. During the next six months, it may be too soon to determine if some of these trends will become a new permanent reality; much probably will depend on the direction and duration of the war and the health of the global economy. Nonetheless, the conflict and pandemic-induced economic fragilities are forcing some countries to pursue policies designed to strengthen their resilience.

- [redacted] **Export Restrictions Aggravating Shortages.** Higher global commodity prices and the specter of social discontent have led a number of governments to restrict exports of essential food items, which has further restricted global supply and increased volatility in markets. Although to date most export restrictions have been short-lived, governments at least during the next six months probably will continue to evaluate their degree of vulnerability to unrest and restrict exports as needed.

- (U[redacted]) [redacted] Last year, China and Russia began restricting exports of fertilizers, and Russia increased export barriers on key agricultural commodities, including its export tax on wheat.

- (U[redacted]) **Diminished Focus on Meeting Climate Change Goals.** Worldwide, the focus of many governments on managing the effects of projected energy shortfalls, high debt burdens, and increased food prices may reduce their willingness to aggressively implement or expand upon emissions reduction pledges. At the same time, increasing economic constraints in many developing countries will be likely to escalate these governments' demands that wealthier countries step up to finance renewable energy and adaptation projects at COP27 in Egypt this November.

(U) Wildcards That Could Alter Current Trends

[redacted] Russia's invasion of Ukraine combines with lingering fragilities from the COVID-19 pandemic have heightened vulnerabilities, making some localized events more prominent in influencing global trends.

- (U[redacted]) A harsh winter in Europe would complicate European countries' chances of mitigating the political and economic effects of Russia's ongoing reduction in natural gas exports to Europe, risking further deterioration in global economic growth.

- (U[redacted]) The emergence of more transmissible or virulent strands of COVID-19 in large economies or export nodes could prompt more lockdowns and further disrupt shipping. A labor standoff in German ports, along with rising COVID-19 infections and quarantine measures, reduced worker availability at Hamburg's container terminals as of July, and delayed shipping.

- (U[redacted]) Falling demand and economic activity could sharply depress commodity prices, providing some relief to import-dependent economies and reducing Russia's economic clout.

- (U[redacted]) **Rising Need for Global Economic Support.** The rapid increase in debt from the pandemic and the economic pressures stemming from the war in Ukraine will be likely to lead to increased calls by debtor nations for debt payment moratoriums and restructurings, which have become more difficult in recent years because of the increased diversity of creditors.

[redacted] Russia–Ukraine War Worsening an Already Bleak Outlook for China's Economy

[redacted] We assess that China is trying to preserve its economic and security partnership with Russia in a manner that limits international criticism and avoids sanctions but at the same time allows it to exploit Russia's isolation to its advantage. Beijing's concerns about its energy and food security and financial stability all predate Russia's invasion of Ukraine, probably contributing to China's increased purchases of oil from Russia. Since at least April, Russian producers have discounted the price of oil exports to China at roughly $25-35 per barrel below the world market rate to retain sales to China, according to industry reporting.

[redacted] As a result of the Russia–Ukraine war, continued COVID-19 outbreaks and prevention measures in China, slowing global economic growth, and China's own internal economic challenges, China's economy is slowing, well below the nearly 8-percent pace recorded from 2010 to 2021. This decline in economic growth within China brings additional risks to global economic growth, given that China accounts for 20 percent of the world economy and 15 percent of global trade.

- (U) A broad consensus of private-sector economic forecasters estimate that China's GDP growth this year will be about 3.5 percent, because of the uncertain direction of COVID-19, related lockdowns, and debt overhangs from the property sector.

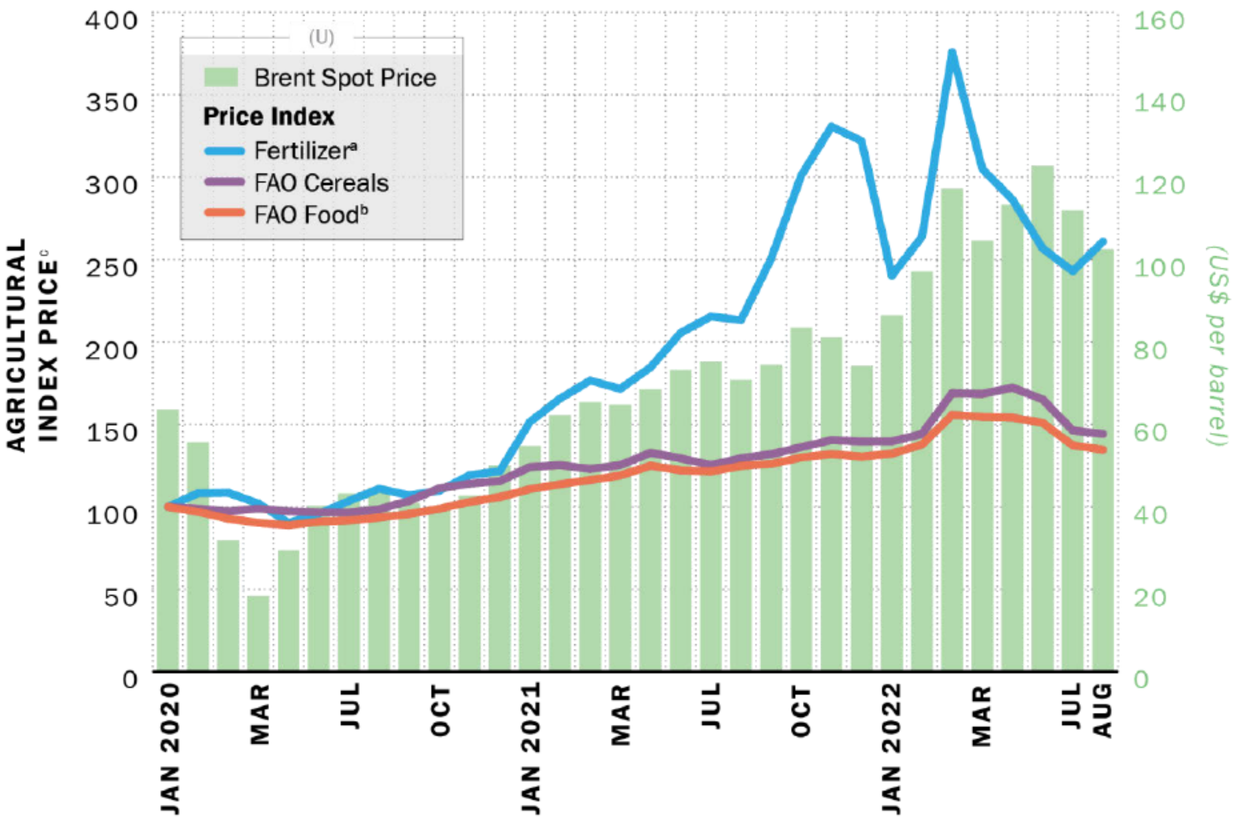
- (U) China has taken advantage of Western sanctions and discounted Russian oil prices to increase the volume of imports of Russian oil. In May, Russia overtook Saudi Arabia as China's top oil supplier. Still, we expect that China is unlikely to raise its import level of oil from Russia much beyond current levels of about two million barrels per day, given the country's infrastructure limitations, slowing economy, and the leadership's probable unwillingness to become overly reliant on any one supplier.

- [redacted] The role of China's currency, the renminbi, in global payments probably is growing, particularly between Russian and Chinese firms, because sanctions have limited Russia's ability to use the SWIFT messaging system. According to SWIFT, Russian firms and banks were involved in almost 4 percent of international renminbi payments by value in July, an increase from 1.4 percent in June, and none in February, preceding the invasion.

(U) Annex

(U) Russia–Ukraine War Compounding Price Pressures on a Range of Commodities

[redacted] A combination of depressed agricultural exports from Ukraine, sanctions against Russia, extreme weather events, and lingering supply chain disruptions has increased prices for a number of global commodities, particularly energy, fertilizers, and food. Market dynamics and uncertainties surrounding the impact of upcoming sanctions and Russian responses probably will maintain upward pressure on prices for at least the next six months.



a. (U) *Data include prices for key fertilizers, including ammonia, urea, phosphates, and potash. The index reflects benchmarks from major markets.*
b. (U) *The FAO Food Price Index captures the monthly change in international prices of a basket of food commodities and consists of the average of five commodity group price indices weighted by the average export shares of each of the groups.*
c. (U) *The index aggregates distinct measurements to facilitate comparisons.*
(U) *Sources: Energy Information Administration (DOE); UN Food and Agriculture Organization; Bloomberg.*

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